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# In the Supreme Court of the United States

OCTOBER TERM, 1954

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No. 686

F. C. DUMAINE, JR., PETITIONER

*v.*

SECURITIES AND EXCHANGE COMMISSION

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*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT*

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## BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

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### OPINIONS BELOW

The opinion of the Court of Appeals (Pet. 16–24) is reported at 218 F. 2d 308. The petition for a writ of certiorari was filed on March 31, 1955. The opinion of the United States District Court for the District of Massachusetts (R. 292a–295a) is reported at 120 F. Supp. 460.

### JURISDICTION

The judgment of the Court of Appeals was entered on December 31, 1954. The jurisdiction of this Court is invoked under 28 U. S. C. 1254, which is made applicable by Section 24 (a) of the

Public Utility Holding Company Act of 1935, 49 Stat. 803, 834, 15 U. S. C. 79x.

### QUESTION PRESENTED

Whether, under the Public Utility Holding Company Act of 1935 and the rules promulgated thereunder, the Securities and Exchange Commission may properly deny compensation for services to a member of a voluntary stockholders' committee, where during the course of the reorganization the claimant's wife, with his knowledge and with resulting benefit to him, sold securities of the company being reorganized.

### STATUTES AND RULE INVOLVED

Section 11 (e) of the Public Utility Holding Company Act of 1935, 49 Stat. 803, 822, 15 U. S. C. 79k, is set forth in the Appendix, *infra*, pp. 19–20. For purposes of comparison with Rule U–62, Section 249 of the Bankruptcy Act, as amended, 52 Stat. 840, 901, 11 U. S. C. 649, is set forth in the Appendix, *infra*, p. 20.

Rule U–62 promulgated by the Securities and Exchange Commission under the Public Utility Holding Company Act of 1935, in pertinent part provides:

> Rule U–62 * * *
>
> (g) *Conditions imposed on persons making solicitations.*—
>
> * * * * *
>
> (2) No securities of the company or companies in reorganization * * * shall

be bought or sold by or for the account of (whether as principal, agent, trustee, or otherwise) any of the persons specified in clauses (A) to (E) below, or in any transaction in which any such person has any beneficial interest, direct or indirect; nor shall any investment advice with respect to any such securities be given, directly or indirectly, by—

(A) Any person who makes any solicitation subject to this rule; or

(B) Any person connected with any committee or other organization formed to act under the authorization so solicited; * * *

**STATEMENT**

This case involves a denial of compensation for services rendered by petitioner in connection with the reorganization of Eastern Gas and Fuel Associates (Eastern) pursuant to Section 11 (e) of the Public Utility Holding Company Act of 1935 (the Act). The Securities and Exchange Commission disallowed petitioner's claim for compensation because, during the course of the reorganization and with petitioner's knowledge, his wife had sold certain shares of Eastern stock at a profit with a resulting benefit to petitioner (R. 266a–268a). The Commission held that this sale had violated its rule prohibiting transactions in which a reorganization committee member had an interest. The United States District Court for the District of Massachusetts reversed the denial of petitioner's fee application (R. 292a–

295a). On appeal, the First Circuit vacated the District Court's order, thus reinstating the Commission's holding denying compensation (Pet. 16–24).

1. *Proceedings before the Securities and Exchange Commission.* In 1945, the Commission began proceedings against Eastern, a registered holding company, to bring about Eastern's compliance with the requirements of Section 11 of the Act. Following extended hearings, an amended plan of reorganization was finally approved and consummated pursuant to Section 11 (e).

In its findings and opinion of February 3, 1950, the Commission had conditioned approval of Eastern's then pending reorganization plan on its being modified to incorporate, *inter alia,* a provision that Eastern would pay such fees and expenses in connection with the plan as the Commission might determine, award or allocate (R. 212a), and the plan was so amended (R. 38a–39a). In approving the amended plan, the Commission specifically reserved jurisdiction to determine the reasonableness of fees and expenses. *Eastern Gas and Fuel Associates,* Holding Company Act Release No. 9725, March 13, 1950. The District Court, which enforced the plan, similarly reserved jurisdiction over fees and expenses (Pet. 18).

Petitioner F. C. Dumaine, Jr., was among the applicants for allowance of fees and expenses (R. 232a), applying for an award of $5,000 for

approximately 550 hours of work devoted to the reorganization, and for reimbursement of $9,599.51 expenses. The Commission denied the fee application but allowed reimbursement of expenses in full. The pertinent facts regarding his fee claim may be summarized as follows:

When the proceedings began in June 1945, petitioner, his wife, and certain other holders of the company's 6-percent preferred stock entered individual appearances in the proceedings. In April 1946 petitioner and another formed a committee for the purpose of representing the 6-percent preferred stockholders. After it had duly qualified pursuant to the requirements of the Commission's Rule U–62, this committee solicited authorizations to represent the holders of that class of stock (R. 263a). Thereafter, Mrs. Dumaine was among those whom the committee represented. As counsel, the committee retained the same firm which had represented the Dumaines individually (R. 233a).

The Dumaine family had a direct or indirect interest in 11,500 shares of 6-percent preferred stock when the reorganization proceedings were initiated (R. 243a). Mrs. Dumaine owned 200 shares which she had purchased at prices between $35.62½ and $37 per share in September 1941 (R. 267a). In June 1945, when Mrs. Dumaine was first represented in the proceedings, the market price was approximately $57 per share (R. 267a). In April 1946, when the committee was formed, the

market price of the stock was $81 per share (R. 267a). Mrs. Dumaine sold her 200 shares for $79 and $79.50 per share on August 1, 1946, realizing a profit of $8,600.[1] The sale of the stock by Mrs. Dumaine was made with the full knowledge of her husband, while he was serving on the committee, and the proceeds of the sale were applied to the reduction of a bank loan made for the purpose of purchasing the house in which Mr. and Mrs. Dumaine lived (R. 247a, 267a).

In its findings and opinion regarding the applications for fees and expenses, the Commission found that the committee, through the services of its counsel and experts, had contributed materially to the proceedings and to the development of the plan (R. 264a). The opinion noted that, although the plan approved did not confine the common stockholders' participation to a token payment as the committee had urged, the class represented by the committee ultimately received a substantially larger allocation than that originally proposed by Eastern (R. 263a–264a).

However, Rule U–62, *supra*, pp. 2–3, under which the petitioner's committee qualified, imposes upon those who make solicitations subject to the rule an interdiction against any trading during the

[1] By September 1950, just before the plan was consummated, the market price of the stock had declined an additional $15 per share, for during that month it sold for between $60.75 and $64.87½ per share. Standard and Poor's Stock Guide, October 1950, p. 64.

course of the proceedings in the securities affected by the reorganization. It provides that such persons shall have no beneficial interest, direct or indirect, in any purchase or sale of the securities during the reorganization, and shall give no investment advice with respect to such securities. On the basis of this express prohibition, the Commission held petitioner disqualified from receiving an allowance of compensation for his services by reason of Mrs. Dumaine's sale of her Eastern stock (R. 266a–268a). However, the Commission permitted the $8,600 profit made on the sale of the stock to be retained and authorized the payment of $9,599.51 expenses claimed by petitioner (R. 284a).

2. *Proceedings before the courts.* On July 27, 1953, the Commission filed in the United States District Court in Massachusetts a supplemental application for approval of the payment and denial of fees and expenses as determined by the Commission (R. 278a). Petitioner, among others, filed objections to the supplemental application (R. 291a). After a hearing, the court filed a memorandum opinion and a supplemental order granting the Commission's application in all respects except as to petitioner's claim for compensation, which the court held should be allowed (R. 292a, 296a).

The Commission appealed from that portion of the court's order which directed it to re-

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quire Eastern to pay a $5,000 fee to the petitioner. The Court of Appeals agreed with the Commission that Mrs. Dumaine's transactions violated Rule U–62, vacated the order of the District Court, and directed the entry of an order disallowing petitioner any compensation. In so ruling, the court specifically limited its consideration to the precise question before it, i. e., "whether the Rule is violated when during a reorganization the wife of a member of a stockholders' committee, with her husband's knowledge, sells shares of stock represented by her husband's committee which she purchased with her own personal funds before reorganization, and uses the proceeds of the sale to reduce a loan incurred in the purchase of a family residence" (Pet. 22).

## ARGUMENT

### I. The court below correctly held that the sale of Eastern stock by petitioner's wife during the reorganization violated Rule U–62

The benefits resulting from participation of stockholder committees in the reorganization process are widely recognized. The committee provides the means whereby investors as a class may take part in the proceedings, so that the interests of the class may be properly represented. Absent the committee vehicle, representation would depend entirely upon chance participation by individual shareholders of varying degrees of sophistication in financial matters, and would frequently not be economically feasible.

It is likewise well recognized that those who voluntarily form such a committee and act as its members assume a fiduciary position. As fiduciaries, they are, of course, held to the highest standards of ethical conduct. Members of a protective committee, like other corporate insiders, are in a strategic position to acquire superior information about the financial condition of the company affected by the proceeding, prospects for reorganization plans affecting the value of their securities, and the like. Often they obtain information not generally available to the public or at a time prior to public disclosure; often they are able to shape or influence the course of the reorganization proceeding. Under such circumstances, the fiduciary may be tempted to put personal profit above allegiance to those he represents.

Rule U–62 provides, *inter alia,* that no securities of the company in reorganization shall be bought or sold in any transaction in which a person connected with a committee qualified under the rule has any direct or indirect beneficial interest. The purpose of this rule is to insure that committee members faithfully discharge their trust, uninfluenced by personal considerations such as the effect their decisions might have upon the market. As the court below stated (Pet. 22–23):

> By the Rule the Commission, quite properly and very obviously, was attempting to

> implement and enforce the wholesome principle that committee members should wholeheartedly serve only one master, the holders of the stock represented by the committee, without any of the purely personal distractions necessarily incident to trading in the stock for individual gain.

The rule is prophylactic in character, requiring no proof of actual abuse of trust or of trading on the basis of foreknowledge of events. This is necessary because of the insuperable difficulties of determining whether inside information was actually used or whether the particular transaction affected the judgment or loyalty of the fiduciary. Thus both the purpose of the rule and its broad language cover transactions by the wife of a fiduciary from which he may benefit. Any other construction would open the rule to easy evasion.

The facts of this case forcefully illustrate the necessity for this construction. Not only were the proceeds of the sale used for their common benefit, but petitioner had specific knowledge of his wife's action. Even assuming petitioner maintained but a passive interest in the transaction, if he had had information which would indicate that the sales at the time they were made would be unwise it is highly probable he would have advised her against it. In effect, husband and wife under these circumstances constitute a single economic unit, and the husband possesses

a clear "beneficial interest, direct or indirect", in the transaction.[2]

The use of the phrase "beneficial interest, direct or indirect" was not inadvertent. The prophylactic nature of the prohibition in the rule is designed to remove any possibility that the committee member may profit from inside knowledge, which may be unknown to the general public, of proposed steps to be taken in the reorganization process. Consequently, the rule must be phrased, as it is, in the broadest possible terms. An indirect interest would include interests held in trust, interests held by entities closely affiliated with the committee member, and other interests which may be insufficient to constitute direct legal ownership, but which furnish a sufficient connection or opportunity for personal profit to require the prophylactic application of the rule.

Petitioner contends that "Rule U-62 should not be applied to any class of persons unless the wording of the Rule clearly embraces them" (Pet. 6). When regulating relationships in this area

[2] In its opinion, the Commission stated generally that "the clear intendment of Rule U-62 is that trading by members of the immediate family of any person connected with a committee falls in the category of prohibited trading by that person" (R. 268a). It is at this statement from the Commission's opinion that petitioner's claim of conflict appears to be directed rather than at the actual holding of the Court of Appeals (Pet. 10). The decision of that court was expressly limited to the specific facts here involved (Pet. 22) and was based upon husband and wife constituting an economic unit.

both legislatures and administrative bodies, in their statutes and regulations, have found it necessary to balance the desirability of specificity against the opportunity too great a specificity would create for evasion. The rule therefore prohibits, in general language, any transactions in which committee members have "any beneficial interest, direct or indirect". This is sufficiently all-inclusive to prevent the abuses at which the rule is directed, but is not so detailed that it can serve as a blueprint for evasion.

The Commission has consistently rejected any interpretation of Rule U–62 which would limit it solely to the transactions of the committee member, regardless of trading carried on with his knowledge by members of his immediate family living in the same household. Thus, it stated in 1947, in its opinion in *American States Utilities Co.*, 26 S. E. C. 718, 728:

> It is the general rule that, because of the close bonds and interdependent economic ties inhering in the marital and family relationships, where a fiduciary is barred from certain dealings the prohibition is applicable equally to his wife and other relatives.

The construction of Rule U–62 adopted by the Commission and by the court below also finds support in the generally recognized rule of equity that when a fiduciary is barred from certain dealings the prohibition is applicable equally to his wife and

other near relatives.[3] In view of the close bonds of the marital relationship and the interdependent economic ties, the fiduciary's spouse cannot, with his knowledge, engage in activities barred to the fiduciary himself.

Rule U–62 evidences its purpose in the broad scope of its interdiction. It prohibits trading by committee members, for their account "as principal, agent, trustee, or otherwise", "or in any transaction in which such person has any *beneficial interest, direct or indirect*". (Italics added.) The use of the word "or" is significant when coupled with the phrase "beneficial interest, direct or indirect". If the phrase is to be given any meaning it must include something other than transactions "as principal, agent, trustee, or otherwise". The court below thus correctly held that the rule was intended to cover just such a situation as is here involved, where the ownership is in another but the relationship, contractual or otherwise, is so close that the same standards of fiduciary conduct must be enforced.[4]

[3] See the cases collected in 131 A. L. R. 990 (1940). See also *Holman* v. *Ryon*, 56 F. 2d 307, 311 (C. A. D. C.); *In re Fulton's Will*, 253 App. Div. 494, 2 N. Y. S. 2d 917, 919 (1938); 2 Scott on Trusts (1939), p. 867.

[4] Even in the absence of a rule, enforcement of the standards in this rule might be appropriate, at least to the extent of reducing a fee allowance by the amount of the profit made in the trading. See *S. E. C.* v. *Chenery Corp.*, 332 U. S. 194. If such a standard were here applied the result would be to deny petitioner a fee.

Each of the grounds upon which petitioner relies in contending that Mrs. Dumaine's trading does not constitute a violation of the rule was considered and found to be without merit by the Court of Appeals. That court squarely rejected the lower court's conclusion that the Commission's construction of Rule U–62 was "unwarranted and unreasonable," as requiring, without "plain forewarning", that petitioner forfeit a fee for beneficial services or that his wife's holdings be frozen during the reorganization.[5] In so holding, the Court of Appeals found "the Rule is clear enough to give Dumaine, as a fiduciary, fair warning as to the possible consequences to him of his wife's transaction" (Pet. 24). In addition, it refused to accept petitioner's contention that the rule must be limited to recognized legal or equitable rights (Pet. 22). Furthermore, as we have noted, *supra*, p. 8, the Court specifically limited its discussion to the precise situation before it, thereby avoiding any broad pronouncement as to the proper interpretation of the rule.

Thus the Court of Appeals correctly held that the sales by Mrs. Dumaine violated Rule U–62.

**II. The decision below does not conflict with the decisions of other courts**

Petitioner suggests (Pet. 14) that there is some variation among the decisions of various courts

[5] We fail to see how the petitioner has standing to complain that his wife's holdings may be frozen where such is a consequence of his own voluntary action.

of appeals and district courts as to the circumstances under which a fiduciary may have a "beneficial interest, direct or indirect" in transactions of relatives within the meaning of the Commission's Rule U-62 or the comparable provision in Section 249 of the Bankruptcy Act, 52 Stat. 840, 901, 11 U. S. C. 649, *infra*, p. 20. Although petitioner cites various related cases (Pet. 12-13) in suggesting the existence of what he calls a "substantial conflict" (Pet. 11), a careful reading of his petition shows that, as to the actual decision below, he asserts a conflict with but a single case—which is properly distinguishable on the facts. He is not urging a true conflict with the other cited decisions, but rather a general dissatisfaction with the state of the law on the subject of trading by relatives of a fiduciary.

The one case alleged to be conflicting is the Second Circuit's opinion in *Berner* v. *Equitable Office Building Corp.*, 175 F. 2d 218, which arose under Section 249 of the Bankruptcy Act, *infra*, p. 20. The analysis upon which petitioner attempts to support his claim of conflict is abstruse and we shall not try to restate it. It is sufficient to note that that case differs from the case at bar in many respects and particularly in that the trading there involved was by a brother-in-law of the fiduciary and did not result in any economic benefit to the fiduciary. In the present case, the sale was by the fiduciary's wife with

whom he was living and resulted in a benefit to him.

The conclusion below was rested expressly "on the proposition that as a practical matter an economic benefit to a wife is indirectly an economic benefit to a husband, at least when husband and wife are living together as a family unit * * *" (Pet. 23). As the court noted (Pet. 22) petitioner's wife had used—

> the proceeds of the sale to reduce a loan incurred in the purchase of a family residence. Our discussion is confined to the precise question before us; we express no opinion on any other.

The differences in relationship, place of residence, and economic benefit afford a complete answer to petitioner's claim of conflict, without exploring the gloss that he would add to the text of the *Berner* decision.

The only other case cited which requires any comment is *In re Franklin Building Co.*, 178 F. 2d 805 (C. A. 7) (Pet. 13). Petitioner does not assert expressly that there is any conflict between this decision and that in the case at bar. Indeed, as he notes (Pet. 13), the *Franklin Building* case did not arise under or involve a construction of either Rule U–62 or Section 249 of the Bankruptcy Act. It arose under Section 212 of the Bankruptcy Act, a section which does not contain the phrase "beneficial interest, direct or indirect", the proper interpretation of which

is the only question with which we are here concerned.[6]

Although not significant as establishing conflict with the case at bar, other cases cited under Point II of the petition (Pet. 11–15) are significant as showing that courts frequently have gone much further in attributing to the fiduciary a transaction by his wife. As petitioner points out, certain courts have held that a fiduciary may have a beneficial interest in his wife's trading irrespective of knowledge. *In re Central States Electric Corp.,* 206 F. 2d 70 (C. A. 4); *In re Inland Gas Corp.,* 73 F. Supp. 785 (E. D. Ky.). These cases are important in supporting *a fortiori* the proposition that a fiduciary has a "beneficial interest, direct or indirect", in transactions effected by his wife with his knowledge.

Petitioner asserts, without amplification, that the subject of the decision below would be of sufficient importance to justify a grant of his petition even in the absence of a conflict among

[6] Section 212, 52 Stat. at 895, 11 U. S. C. 612, provides:

"The judge may examine and disregard any provision of a deposit agreement, proxy, power or warrant of attorney, trust mortgage, trust indenture, or deed of trust, or committee or other authorization, by the terms of which an agent, attorney, indenture trustee, or committee purports to represent any creditor or stockholder, may enforce an accounting thereunder, may restrain the exercise of any power which he finds to be unfair or not consistent with public policy and may limit any claim or stock acquired by such person or committee in contemplation or in the course of the proceeding under this chapter to the actual consideration paid therefor."

the decisions (Pet. 15). In this connection, too, it must be pointed out that the court below decided only a narrow issue peculiar to the facts involved. Thus no unresolved question of importance is raised.

### CONCLUSION

The case was decided correctly by the court below. There is no conflict and there is no occasion for further review. The petition for a writ of certiorari should be denied.

Respectfully submitted.

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APRIL 1955.

# APPENDIX

## Statutes Involved

Section 11 (e) of the Public Utility Holding Company Act of 1935, 49 Stat. 803, 822, 15 U. S. C. 79k, provides:

> Sec. 11. * * *
>
> (e) In accordance with such rules and regulations or order as the Commission may deem necessary or appropriate in the public interest or for the protection of investors or consumers, any registered holding company or any subsidiary company of a registered holding company may, at any time after January 1, 1936, submit a plan to the Commission for the divestment of control, securities, or other assets, or for other action by such company or any subsidiary company thereof for the purpose of enabling such company or any subsidiary company thereof to comply with the provisions of subsection (b). If, after notice and opportunity for hearing, the Commission shall find such plan, as submitted or as modified, necessary to effectuate the provisions of subsection (b) and fair and equitable to the persons affected by such plan, the Commission shall make an order approving such plan; and the Commission, at the request of the company, may apply to a court, in accordance with the provisions of subsection (f) of section 18, to enforce and carry out the terms and provisions of such plan. If, upon any such application, the court, after notice and opportunity for hearing, shall approve such plan as fair and equitable and as appro-

priate to effectuate the provisions of section 11, the court as a court of equity may, to such extent as it deems necessary for the purpose of carrying out the terms and provisions of such plan, take exclusive jurisdiction and possession of the company or companies and the assets thereof, wherever located; and the court shall have jurisdiction to appoint a trustee, and the court may constitute and appoint the Commission as sole trustee, to hold or administer, under the direction of the court and in accordance with the plan theretofore approved by the court and the Commission, the assets so possessed.

Section 249 of the Bankruptcy Act, as amended, 52 Stat. 840, 901, 11 U. S. C. 649, is set forth for purposes of comparison with Rule U–62, *supra*, p. 2. This section provides:

SEC. 249. Any persons seeking compensation for services rendered or reimbursement for costs and expenses incurred in a proceeding under this chapter shall file with the court a statement under oath showing the claims against, or stock of, the debtor, if any, in which a beneficial interest, direct or indirect, has been acquired or transferred by him or for his account, after the commencement of such proceeding. No compensation or reimbursement shall be allowed to any committee or attorney, or other person acting in the proceedings in a representative or fiduciary capacity, who at any time after assuming to act in such capacity has purchased or sold such claims or stock, or by whom or for whose account such claims or stock have, without the prior consent or subsequent approval of the judge, been otherwise acquired or transferred.

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